Sherwin-Williams Company (SHW)

Updated April 30th, 2020 by Eli Inkrot

Key Metrics

Current Price:	$534	**5 Year CAGR Estimate:**	2.2%	**Market Cap:**	$49.7 B
Fair Value Price:	$400	**5 Year Growth Estimate:**	7.0%	**Ex-Dividend Date[1]:**	05/21/20
% Fair Value:	134%	**5 Year Valuation Multiple Estimate:**	-5.6%	**Dividend Payment Date:**	06/05/20
Dividend Yield:	1.0%	**5 Year Price Target**	$561	**Years Of Dividend Growth:**	42
Dividend Risk Score:	A	**Retirement Suitability Score:**	C	**Last Dividend Increase:**	18.6%

Overview & Current Events

Sherwin-Williams, founded in 1866 and headquartered in Cleveland, OH, is North America's largest manufacturer of paints and coatings. The company distributes its products through wholesalers as well as retail stores (including a chain of more than 4,900 company-operated stores and facilities) to 120 countries under the Sherwin-Williams name. The company also manufactures *Dutch Boy, Pratt & Lambert, Minwax, Thompson's Waterseal, Krylon, Valspar* (acquired in 2017), and other brands. Sherwin-Williams generated annual sales of nearly $18 billion last year and has a market capitalization of $50 billion. With 42 years of consecutive dividend increases, Sherwin-Williams is a member of the Dividend Aristocrats Index.

On April 29th, 2020 Sherwin-Williams released Q1 2020 results for the period ending March 31st, 2020. For the quarter Sherwin-Williams generated revenue of $4.15 billion, up 2.6% compared too Q1 2019, driven by a 7.0% increase in the Americas Group, partially offset by -4.9% and -1.1% respective declines in the Consumer Brands and Performance Coatings segments. Adjusted earnings-per-share totaled $4.08 compared to $3.60 in the prior year quarter.

Previously Sherwin-Williams provided guidance for fiscal year 2020, anticipating adjusted earnings-per-share being in the $22.70 to $23.50 range. However, as a result of the COVID-19 crisis, the company does not see an immediate, meaningful improvement to results. Adjusted 2020 earnings-per-share guidance has been reduced to $19 to $21. Notably, Sherwin-Williams is one of the few companies offering a full year outlook at this time.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$4.21	$4.14	$6.02	$7.26	$8.78	$11.16	$11.99	$15.07	$18.53	$21.12	***$20.00***	***$28.05***
DPS	$1.44	$1.46	$1.56	$2.00	$2.20	$2.68	$3.36	$3.40	$3.44	$4.52	***$5.36***	***$8.64***
Shares[2]	107.0	103.9	103.2	100.1	94.7	92.3	93.0	93.9	93.1	93.4	***93***	***88***

Sherwin-Williams has put together a very strong record in the past, with earnings-per-share growing at a 13.3% average compound rate dating back to 2007. This was driven by solid top line growth, significant margin improvement and a lower share count. More impressive is the idea that the last few years have shown even faster growth, despite coming off a larger base. However, it is important to point out that this has been impacted by one-time items such as a decline in the company's tax rate.

While Sherwin-Williams' historical growth rate is outstanding, we believe that the company is unlikely to replicate this performance moving forward. This is especially true taking into consideration the ongoing COVID-19 pandemic and the expectation drop in earnings this year. We have reduced our earnings estimate to the middle of management's outlook. Still, we believe that Sherwin-Williams is capable of delivering 7% annualized earnings growth over full economic cycles, coming off a lower earnings base for this year. When demand picks up again, growth can come from several factors, including revenue expansion – resting on higher sales at the company's existing stores – margin improvement, share

[1] Estimate

[2] In millions.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

repurchases and general economic growth. The company has reduced its share count by roughly -20% throughout the last decade, and we believe that the number of shares will continue to decline, albeit irregularly, over time.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	17.0	19.8	21.3	24.3	24.1	24.3	23.2	22.8	22.2	23.2	***26.7***	***20.0***
Avg. Yld.	2.0%	1.8%	1.2%	1.1%	1.0%	1.0%	1.2%	1.0%	0.8%	0.9%	***1.0%***	***1.2%***

Sherwin-Williams has been a high-quality growth name during the last decade and indeed over the company's history. As a result, shares have generally commanded a premium valuation – trading hands around 22 times earnings on average during the last 10 years. Given a slower (but still impressive) anticipated growth rate, we are using 20 times earnings as a starting point for fair value. With a multiple near 27 times our expectation of this year's earnings, shares could face a significant valuation headwind if shares were to revert back toward 20 times earnings.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	34%	35%	26%	28%	25%	24%	28%	23%	19%	21%	***27%***	***31%***

Sherwin-Williams has raised its dividend consistently for decades, but its dividend payout ratio has never risen to a high level. Indeed, the payout ratio has actually declined in the last decade, as dividend increases have trailed earnings-per-share improvement over the years. While the dividend appears exceptionally well covered, the combination of a low payout ratio and above average valuation make for a lackluster dividend yield.

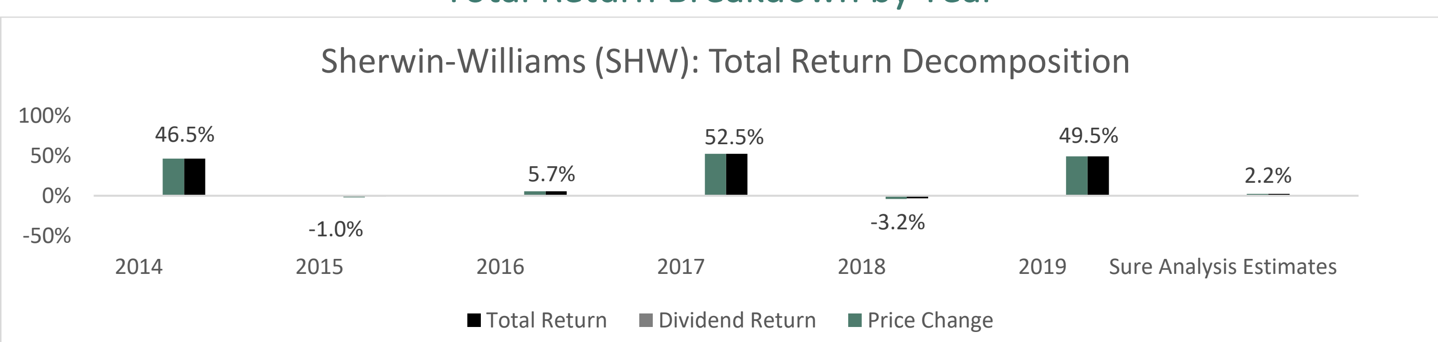
Sherwin-Williams is not necessarily in a high-growth industry, but its entrenched position offers the company its fair share of competitive advantages; allowing the business to grow consistently. Further, acquisitions are a way for Sherwin-Williams to enhance its presence, with the recent Valspar transaction being a good example.

During the last recession Sherwin-Williams posted earnings-per-share of $4.70, $4.00, $3.78 and $4.21 over the 2007 through 2010 stretch (with a growing dividend to boot). This is somewhat surprising for a company in the paints and coatings industry – generally thought to be a cyclical business – but illustrates the underlying strength of the company.

Final Thoughts & Recommendation

Shares are down -7% since our last report, while earnings are expected to be lower as well. Sherwin-Williams has been a great investment during the majority of the last decade. However, moving forward we are forecasting just 2.2% total return potential, stemming from 7% growth and a 1.0% starting dividend yield offset by the potential for a meaningful valuation headwind. While we are not enthused by the current valuation, we are encouraged by the underlying strength of the business and continue to rate shares as a hold.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	7776	8766	9534	10186	11130	11339	11856	14984	17534	17901
Gross Profit	3481	3745	4206	4617	5164	5560	5921	6719	7419	8,036
Gross Margin	44.8%	42.7%	44.1%	45.3%	46.4%	49.0%	49.9%	44.8%	42.3%	44.9%
SG&A Exp.	2728	2961	3260	3468	3823	3886	4140	4798	5034	5,275
D&A Exp.	175	181	179	188	199	199	197	492	596	
Operating Profit	746	775	940	1152	1305	1615	1713	1699	1890	2448
Operating Margin	9.6%	8.8%	9.9%	11.3%	11.7%	14.2%	14.4%	11.3%	10.8%	13.7%
Net Profit	462	442	631	753	866	1054	1133	1728	1109	1541
Net Margin	5.9%	5.0%	6.6%	7.4%	7.8%	9.3%	9.6%	11.5%	6.3%	8.6%
Free Cash Flow	581	582	731	917	881	1213	1070	1661	1693	
Income Tax	215	300	276	333	392	495	463	-300	251	441

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	5169	5229	6235	6383	5699	5779	6753	19900	19134	20514
Cash & Equivalents	59	33	863	745	41	206	890	204	156	162
Accounts Receivable	917	990	1033	1098	1131	1114	1231	2105	2019	2089
Inventories	918	927	920	971	1034	1019	1068	1742	1815	1890
Goodwill & Int. Ass.	1423	1414	1504	1492	1447	1399	1382	12817	12158	11739
Total Liabilities	3560	3712	4443	4608	4703	4911	4874	16252	15404	16391
Accounts Payable	910	965	923	998	1042	1158	1035	1792	1799	1894
Long-Term Debt	1045	993	1705	1722	1799	1950	1953	10521	9344	8685
Shareholder's Equity	1393	1357	1691	1734	996	868	1878	3648	3731	4123
D/E Ratio	0.65	0.65	0.95	0.97	1.81	2.25	1.04	2.88	2.50	2.11

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	9.7%	8.5%	11.0%	11.9%	14.3%	18.4%	18.1%	13.0%	5.7%	7.8%
Return on Equity	34.7%	32.1%	41.4%	43.9%	63.4%	113%	82.5%	62.5%	30.1%	39.2%
ROIC	18.6%	17.1%	21.0%	21.5%	27.5%	37.6%	34.1%	19.2%	8.1%	11.9%
Shares Out.	107.0	103.9	103.2	100.1	94.7	92.3	93.0	93.9	92.9	
Revenue/Share	71.48	82.95	91.74	98.84	112.72	119.94	125.47	157.85	184.60	191.56
FCF/Share	5.34	5.51	7.03	8.90	8.92	12.83	11.32	17.50	17.82	7.8%

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.